In The

Supreme Court of the United States

October Term, 1977

No. 77-1742

THE STATE TAX COMMISSION, THE DEPARTMENT OF TAXATION AND FINANCE OF THE STATE OF NEW YORK,

Petitioner,

v.

HOLLY S. CLARENDON TRUST,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

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The Respondent Holly S. Clarendon Trust prays that the State Tax Commission's Petition for Writ of Certiorari in the above captioned matter be denied.

Jurisdiction

The Respondent maintains that the Court does not have jurisdiction for the reasons stated in Point I of the Argument.

Questions Presented

1. Does the June 11, 1973 amendment to Section 618 (4) of the New York Tax Law which retroactively taxed the Respondent's voluntary sales of stock in February and March, 1972, violate federal due process guarantees?

2. Does the June 11, 1973 amendment to Section 618 (4) of the New York Tax Law which retroactively taxed the Respondent's voluntary sales of stock in February and March, 1972, violate due process guarantees of Article I, Section 6 of the New York Constitution?

Constitutional Provisions and New York Statutes Involved

The Petitioner's otherwise correct recitation of Constitutional provisions and statutes involved should include Article I, Section 6 of the New York Constitution, which provides in pertinent part that:

> "No person shall be deprived of life, liberty, or property without due process of law."

Counter Statement of Facts

The Respondent Holly Clarendon Trust was established in 1949 as a simple, inter vivos New York trust. It is a calendar year taxpayer. In February and March 1972 the Trust sold a substantial amount of its common stock and realized a net long term capital gain of $1,335,206.

The Trust was under no obligation to sell the stock. Contrary to the Petitioner's incorrect statement (Petition, p. 7), the decisions on the sale of stock were made only after the tax costs were considered (See Affidavit of John S. Gilman, Trustee, Appendix A).

The Trust filed a timely 1972 New York State income tax return in March, 1973, reporting a taxable income of $667,003.

The Trust's taxable income was determined in accordance with Tax Law §618, "New York Taxable Income of a Resident Estate or Trust", as it then existed. As provided in that section, the Trust took a $667,603 long-term capital gain deduction. This was 50% of the Trust's $1,335,206 net long-term capital gain. In the Petitioner's instruction booklet for 1972 fiduciary income tax returns (Petition, Appendix F), resident trusts and estates were advised to add back into taxable income 20% of the net long-term capital gain deduction (Petition, p. A-32). This provision conflicted with Tax Law §618, which provided for no such increment in taxable income. This booklet was published in September 1972, nine months before Section 618 was amended and six months after the sale of the stock. The Respondent filed the return in accordance with Section 618 and did not make the adjustment described in the booklet.

On June 11, 1973, three months after the return was filed and almost one and a half years after the stock was sold, Tax Law §618 (4) was amended to provide that 20% of a trust's net long-term capital gain deduction be added back into its taxable income. This amendment was made retroactive to January 1, 1972. On September 19, 1973, the Petitioner sent the Respondent a "Statement of Audit Changes" by which it proposed to increase the Respondent's taxable income by $133,520.60, which was 20% of its $667,603 net long-term capital gain deduction. This adjustment would have resulted in additional tax of $19,359.40, plus interest. The Respondent refused to pay this amount and began proceedings resisting its assessment. The New York courts held that the retroactive application of the statute violated the New York Constitution's and the U.S. Constitution's due process guarantees.

ARGUMENT

Reasons for Denying the Writ

POINT I

The Court has no jurisdiction since the decision of the N.Y. Court of Appeals is based on adequate and independent state grounds.

The Court will not review a state court decision if it is based on an adequate and independent state ground. *Murdock v. City of Memphis*, 20 Wall. 590 (1875); *Herb v. Pitcairn*, 324 U.S. 117 (1945); *Lynch v. New York*, 293 U.S. 52 (1934). Since the judgment of the New York Supreme Court, as affirmed by the New York Court of Appeals, is based equally on the New York Constitution and the United States Constitution, this Court should not grant the writ. This Court stated in *Fox Film Corp. v. Muller*, 296 U.S. 207 (1935):

> . . . where the judgment of a state court rests upon two grounds, one of which is federal and the other nonfederal in character, our jurisdiction fails if the nonfederal ground is independent of the federal ground and adequate to support the judgment. (296 U.S. 207, at 210).

Granting the writ would lead only to an advisory opinion on the merits. Even if this Court reverses the decision below and holds that the questioned statute does not violate the federal due process clause, the statute would nonetheless violate the New York due process clause. This Court warned against such advisory opinions in *Herb v. Pitcairn, supra*, at 125-126.

This case is indistinguishable from *City of New York v. Central Savings Bank*, 280 N.Y. 9, *cert. den.* 306 U.S. 661 (1939). In that case, as here, the New York Court of Appeals held that a state statute violated both federal and New York due process guarantees. The Petitioner cites *only* the Court of Appeals' decision (Petition, p. 13) and conveniently omits the citation of

this Court's subsequent decision denying the writ. That decision is as follows:

> Denied for the reason that the judgment sought to be reviewed rests on a non-Federal ground adequate to support it. (306 U.S. at 661).

The Petitioner relies on the New York Court of Appeals' decision in *Central Savings Bank*, but this Court's subsequent disposition of that case, which the Petitioner overlooks, is conclusive authority for denying the writ.

POINT II

The issue presented lacks national importance and is too narrow to warrant review.

This case does not present the "special and important" elements required by Rule 19. It arose from unusual circumstances which are unlikely to recur.

POINT III

A full hearing by this court would not result in a reversal.

Every New York judge who ruled on this case found the retroactive statute unconstitutional. The New York Court of Appeals disposed of the matter with a terse memorandum decision. All arguments in the Petition have been unanimously rejected below.

POINT IV

The Petitioner's authorities are distinguishable.

The Petitioner emphasizes unrelated sections of the Tax Law to justify the retroactive amendment of Section 618 (4). These are Section 611, "New York Taxable Income of a Resident Individual", and Section 612, "New York Adjusted Gross Income of a Resident Individual". The legislative history of these sections is noteworthy.

In the 194th Session of the New York Legislature, Section 612 of the Tax Law, which relates to the income taxation of *individuals*, was amended to provide for the addition to adjusted gross income of 20% of the net long-term capital gain deduction. (L. 1972, c.1 §9).

In the 195th Session, no action was taken on the sections of the Tax Law pertinent here.

In the 196th Session, the retroactive amendment to Section 618 (4) at issue was made (L. 1973, c.718, §2). The Tax Section of the New York State Bar Association recommended that this amendment be disapproved because of its retroactive application (Letter of Commissioner Gallman, Petitioner Appendix E).

The Petitioner argues that the retroactive amendment to Section 618 merely corrected a technical error in draftsmanship arising when Section 612 was amended. Assuming that an error was made, it does not follow that the "curative" amendment to Section 618 can overreach constitutional limitations. The Petitioner cites no case in which this Court upheld a tax statute made retroactive beyond the preceding legislative session. The Petitioner relies heavily on *Welch v. Henry*, 305 U.S. 134 (1938). That case is distinguishable not only because it dealt with retroactive taxes on dividends, as opposed to voluntary sales, but also because it establishes that retroactive taxes cannot extend beyond the time of the immediately preceding legislative session.

The Petitioner improperly relies on the dissent in *Untemyer v. Anderson*, 276 U.S. 440 (1928), (Petition, p. 10) to justify the retroactive amendment to Section 618. However, almost every case cited in that quote involved taxes made retroactive only to the beginning of the year of enactment. Two statutes cited in the passage were made retroactive to a prior year. These were the Joint Resolution of July 4, 1864 and the Act of February 24, 1919. However, an examination of the legislative history of those two statutes reveals that, unlike the statute in question here, neither was made retroactive beyond the preceding legislative session.

The Petitioner relies on *Shapiro v. City of New York*, 32 N.Y. 2d 96 *rehearing den* 414 U.S. 1087 (1973) (Petition, p. 8). The issue in *Shapiro* was whether the New York City unincorporated business tax could be imposed on professionals. Retroactivity was not an issue, nor was capital gains taxation. Petitioner's quote from *Shaprio* is out of context and misleading in two respects. That quote is as follows:

> If such changes are forbidden in the name of equal protection legislatures in laying new taxes would be left powerless to rectify to any extent a previous distribution of tax burdens which experience has shown to be inequitable, even though constitutional.
> (*Shapiro*, 32 N.Y. 2d 96, at 105, Petition p. 8).

First, the "changes" referred to in the quote were not *retroactive* changes. Second, the quote, which is an excerpt from *Welch v. Henry, supra*, deals with the 14th Amendment's equal protection clause. The Respondent has never claimed a violation of equal protection rights.

The Petitioner's reliance on *Graham & Foster v. Goodcell*, 282 U.S. 409 (1931), is misplaced (Petition, p. 9). That case upheld the extension of the statute of limitations to permit the collection of taxes which, under a previous decision of this Court, had been time-barred. This Court emphasized that the curative statute

was constitutionally permissible in that instance because it did not retroactively create or increase a liability.

The Petitioner suggests that *Milliken v. United States*, 283 U.S. 15 (1931) permits retroactive gift taxes on previously untaxed property transfers (Petition, p. 12). That is incorrect. *Milliken* dealt with the issue of *estate* tax rates applied to gifts made in contemplation of death. Taxation of previous transfers was not an issue because, for estate tax purposes, gifts in contemplation of death are deemed to occur at death. The Petitioner's quotation from *Milliken* is out of context and misleading.

> The present gift was subject to the excise when made, and for reasons already indicated, we think a mere increase in the tax, pursuant to a policy of which the donor was forewarned at the time he elected to exercise the privilege, did not change its character. (*Milliken, supra*, at 24, from the Petition, p. 12).

The "excise" referred to was not a gift tax on the prior transfer. The "excise" was the *estate* tax on the transfer which was deemed to have been made at death. In this regard, retroactive taxation was not an issue.

Phillips v. Dime Trust & S.D. Co., 284 U.S. 160 (1931) has no bearing on this case (Petition, p. 12). *Phillips* dealt with the estate tax on tenancies by the entirety. Retroactive taxation was not even considered in that case.

CONCLUSION

For the reasons stated, the Writ for Certiorari should be denied.

DATED: June 16, 1978

Respectfully submitted,

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APPENDIX

AFFIDAVIT OF JOHN S. GILMAN, TRUSTEE

STATE OF NEW YORK – SUPREME COURT
COUNTY OF MONROE

HOLLY S. CLARENDON TRUST,

Plaintiff,

against

THE STATE TAX COMMISSION, THE DEPARTMENT OF TAXATION AND FINANCE OF THE STATE OF NEW YORK,

Defendant.

Index No. 11100/76

JOHN S. GILMAN, being duly sworn, deposes and says:

1. That I am an attorney admitted to practice in the State of New York and am a partner in the firm of Woods, Oviatt, Gilman, Sturman & Clarke.

2. That I am a trustee of the Holly S. Clarendon Trust, a resident New York trust and plaintiff in the within action.

3. That the trust is a calendar year taxpayer, and that in 1972 it realized net long-term capital gains of $1,335,206 from the sale of stocks in February and March 1972. (Exhibit A)

4. That the taxable income of resident *trusts and estates* is defined by Section 618 of the New York Tax Law. In contrast the taxable income of resident *individuals* is defined by Section 611 and 612 of the Tax Law.

5. That the trust's 1972 taxable income was computed in accordance with Section 618 of the New York Tax Law, entitled "New York Taxable Income of a Resident Estate or Trust." Pursuant to that section as it then existed, the trust took a

deduction of $667,603, which was 50% of its 1972 net long-term capital gains. This was the amount required to be deducted when the long term capital gains were realized and when the return was filed on March 20, 1973.

6. That on July 29, 1974 the State Tax Commission issued a notice of deficiency and statment of audit changes which attempted to assess an additional tax of $19,359.40 against the trust. This amount was computed by adding 20% of the trust's aforesaid long-term capital gains deduction back into its taxable income. *(Exhibit B)*

7. That the Tax Commission based its proposed deficiency on two grounds. First, it claimed that a 1972 amendment to Section 612 of the Tax Law, which added back into a resident *individual's* taxable income 20% of the long-term capital gains deduction, also applied by inference to Section 618 of the Tax Law. However, in 1972, Section 618 of the Tax Law, the only statutory definition of a resident trust's taxable income, made no reference whatsoever to the portions of Section 612 dealing with the capital gains deduction. Thus, the Tax Commission wholly disregarded the clear language of Section 618 as it existed in 1972. There is absolutely no authority for computing a trust's taxable income other than in accordance with Section 618.

8. That the Tax Commission's second argument for assessing the proposed deficiency is based on an amendment to Section 618 passed on June 11, 1973. That amendment incorporates by reference the language of Section 612 which adds back to taxable income 20% of the long-term capital gains deduction. This amendment was made applicable to all tax years of trusts and estates beginning on or after January 1, 1972. The retroactive application of this amendment is repugnant to the due process guarantees of Article I Section 6 of the New York Constitution and the 5th and 14th Amendments to the United States Constitution. See Point III of plaintiff's Memorandum of Law.

9. That as trustee of the Holly Clarendon Trust, I was under no obligation to sell the stocks giving rise to the long term capital gains in question. I could have sold less stock, different stock, or no stock at all. In reaching the decision to sell those shares, one of the factors I considered was the tax cost.

10. That the Trust followed administrative channels in seeking a correction of this proposed deficiency. In the two years following the issuance of the notice of deficiency, telephone conferences were made, a petition was filed, and an administrative hearing was held, but no decision was reached by the Tax Commission. Finally, four days after this suit was filed and almost ten months after the administrative hearing, the Tax Commission ruled that it had no jurisdiction to find a statute unconstitutional. *(Exhibit C)*. It is very clear that administrative relief is illusory in this case. New York courts permit suits for declaratory judgment without resorting to administrative remedies where the constitutionability of a tax statute is in issue. (See Part I of plaintiff's Memorandum of Law). Furthermore, the defendant's dilatory practices in reviewing this matter caused the trust to incur needless and extraordinary expenses.

/s/ JOHN S. GILMAN
John S. Gilman *Trustee*

Sworn to before me
this 23rd day of
September, 1976

/s/ EUGENE PARRS
Notary Public

EUGENE PARRS
Notary Public in the State of New York
MONROE COUNTY, N.Y.
Commission Expires March 30, 1978